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IN THE

Supreme Court of the United States

DAVID E. WELCH, CPA, PETITIONER

v.

ELAINE L. CHAO, SECRETARY OF LABOR, UNITED STATES DEPARTMENT OF LABOR, AND CARDINAL BANKSHARES CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

REPLY BRIEF

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OVERVIEW

> "And today I sign the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt. This new law sends very clear messages that all concerned must heed. This law says to every dishonest corporate leader: you will be exposed and punished; the era of low standards and false profits is over; no boardroom in America is above or beyond the law."

[U.S. President George W. Bush, signing the Sarbanes-Oxley Act July 30, 2002]

The Department of Labor terms Petitioner's claim under SOX "unremarkable," while Cardinal suggests Petitioner is "foreclosed" since he "does not even mention, let alone challenge, the Court of Appeals dispositive ruling on the waiver issue."

Focus on the discrete issues raised by Petitioner, in a vacuum, clouds the fuller picture David Welch painted with his protected communications. Petitioner, with the enactment of SOX, faced unchartered territory. He would be held personally responsible, civilly and criminally, should he erroneously certify the bank's public financial report 1) ". . . fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (2) the information . . . fairly presents, in all material respects, the financial condition and results of operations."

Welch emphatically stated he could not so certify because:

- He had been isolated from the bank's Audit Committee as well as its outside auditor [JA 275, 276, 277];

- There were unresolved issues regarding the fair presentation and accuracy of "material (financial) items;" [JA 283, 276, 277];

- He could not vouch for the bank's "establishment" and "effectiveness" of financial disclosure controls (internal controls) and procedures; and

- CEO Leon Moore was "managing income" by directing journal entries through unauthorized personnel.

ARGUMENT AND AUTHORITIES

A. Welch's Communications "Definitively and Specifically" Related to SOX §1514A, and Went Far Beyond GAAS and GAAP

The Fourth Circuit confirmed the ARB's second rationale for dismissal of the Welch complaint, stating Welch failed to explain "how he could have an objectively reasonable belief that these (the bank's) actions violated any of the laws listed in §1514A." [*Welch v. Chao*, No. 07-1684 at 13]

The bank argued the "ALJ erred in finding protected activity because Welch's complaints . . . did not allege conduct that constituted a violation of. . . federal securities laws." [Id.] The Fourth Circuit concluded Welch "utterly failed to explain how Cardinal's alleged conduct could reasonably be regarded as violating any of the laws listed in §1514A" of SOX.

Relevant sections of SOX include:

• **Section 302** requires the CEO and CFO to certify, on each annual or quarterly financial report submitted pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, the following:

1) They have reviewed the report;

2) The report does not contain any untrue statement of material fact or omit a material fact necessary to make the statement made not misleading;

3) Based on their knowledge, the financial statements fairly present in all material respects the financial condition and results of operations of the issuer for the periods presented;

4) The CEO and CFO are responsible for establishing and maintaining internal controls; that they have designed such to insure material information is made known to such officers by others; that they have evaluated the effectiveness of

the internal controls within 90 days of their certification; that they have presented their conclusions about the effectiveness of the internal controls in their report; that they have disclosed to the issuer's auditors and audit committee all significant deficiencies in design/operation of the internal controls and have identified material weaknesses of the internal controls; the CEO and CFO must identify any fraud, whether or not material, involving management or other employees having a significant role in the issuer's internal controls; and

5) Whether there have been significant changes in the internal controls or other factors that could affect internal controls subsequent to their evaluation, including corrective actions with regard to significant deficiencies and material weaknesses.

• **Section 404** requires management assessment of internal controls through each annual SEC report required by Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m). The report shall (1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; (2) contain an assessment of the effectiveness of the internal control structure and procedures for financial reporting.

• **Section 806** provides whistleblower protection for employees from being, among other

things, discharged for providing information regarding conduct the employee reasonably believes constitutes a violation of . . . any rule or regulation of the Securities and Exchange Commission to a person with supervisory authority over the employee.

• **Section 906** This section requires a written statement by the CEO and CFO that the financial statements fully comply with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m) or 78o(d), and that the information "fairly presents, in all material respects, the financial condition and results of the issuer." It also provides fines and penalties against the CFO of an issuer for false SOX certification up to and including $5,000,000 or 20 years imprisonment, or both.

These precise issues were advanced by Welch before OSHA, the ALJ, the ARB and the Fourth Circuit.

Welch filed his SOX complaint with OSHA December 12, 2002. He alleged SOX required him, as CFO of Cardinal, to certify "the accuracy of reporting forms filed with the Securities and Exchange Commission, in particular Form 10-QSB." [JA 16] Welch refused to certify the bank's 10-QSB and refused to sign the SOX certificate due to material, financial inaccuracies [JA 283].

Welch indicated, by memorandum to the bank's CEO, R. Leon Moore, that he (Welch) could not state, pursuant to the SOX certificate, the bank's financial report "did not contain any untrue statement of a material fact or omit to state a material fact necessary

to make the statement made . . . not misleading with respect to the period covered by the quarterly report." [JA 17]

The OSHA complaint alleged Welch could not certify the "financial statements, and other financial information included in the Quarterly Report on Form 10-QSB fairly presented in all material respects the financial condition, results of operations and cash flows . . . for the periods presented in the quarterly report." [JA 18] Neither could Welch certify the SOX mandated 10-QSB complied with SOX requirements concerning "internal financial controls and procedures (as defined in Exchange Act rules 13a-14 and 15d-14)." [Id.]

On August 14, 2002, Welch sent a memorandum to the bank's CEO, Leon Moore. [JA 275] Welch raised material, financial issues concerning the quarter ended June 30, 2002, after enactment of SOX.

> I am unable to reconcile their (the outside auditor's) numbers to ours. There are no explanatory notes that might help explain the differences. More importantly . . . I cannot give any assurances that our financials are fairly presented. For example, last year, you approved journal entries for the $45,000 and $150,000 recoveries of written off loans to be entered as other income and other real estate income. In spite of my repeated attempts to get you to correct the entries, you stood firm against any changes . . .Just last month, while performing a routine review of some of the entries you had authorized at 2001 year end charging $4,500.00 in expenses against 2001 income. Then, in May, you

> authorized the reversal of those entries. The result of these two sets of entries was a decrease in taxable income in 2001, a decrease in expenses in 2002 and an increase in net income for 2002 . . . **[T]his type of accounting does not meet GAAP ("Generally Accepted Accounting Principles). It also hints of "managing" net income which has always been unethical and now is seriously illegal.**
>
> **Not only can I not certify the accuracy of Cardinal's financial statements as required by our most recent legislation (SOX), I cannot offer assurances as to their fair presentation as presented in the 10-QSB you asked me to review.** Since Larrowe & Company lists you as the Principal Financial Officer of Cardinal . . . you may certify the accuracy of the financial statements as presented, but I cannot." [JA 275]

On September 13, 2002, Welch issued a second memorandum to Moore regarding the SOX certificate. [JA 276] Attached to this memorandum Welch affixed the very certification required by SOX Section 302, and noted:

> I have attached a Section 302 certification that contains the verbage required by the Sarbanes-Oxley Act of 2002 along with explanatory notes. The Section 302 certification is required each quarter beginning with the September 30, 2002 10-QSB . . . **I will not be able to certify the 3rd quarter's 10-QSB. The certification submitted with your 'signature' last quarter**

> **will not suffice this quarter for two reasons. First, the Section 302 certification noted above must now be submitted. Second, there are material items in the 2001 3rd quarter figures and 2001 3rd quarter year to date figures that should be restated. The restatement should be done . . . to avoid the unfair presentation of financial statements which could lead a reasonable investor to make a decision they might otherwise not make."** [Id.]

The September 2002 memo detailed why Welch could not SOX certify the 10-QSB. He noted the "3rd quarter 2001 income should be restated to properly account for $195,000 (in loan) recoveries," otherwise he could not certify the quarterly report would **"fairly present in all material respects the financial condition"** of the bank and **"would not be misleading."** [JA 277, 278, 280]

In the September 13, 2002 memorandum [JA 276] Welch noted he could not certify "all significant deficiencies in the design or operation of **internal (financial) controls** which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls," since Leon Moore, CEO of the bank, "was the only person who reports to the board;" because Welch "had been instructed" by Moore "not to address the audit committee;" and because Moore "had been the (practically) exclusive contact with (outside auditors) Larrowe & Company."

At JA 283, Welch noted the **stringent criminal penalties** which attach to a "knowing . . . statement which does not comport" with SOX, including a fine of "not more than $5,000,000 or imprisoned not more than 20 years, or both." [Id.]

Contrary to the Fourth Circuit's assertions, Welch very specifically, by memoranda and multiple exhibits with detailed notes, explained his precise "theory of the case."

B. Welch's Complaints to Cardinal were Self Enunciating – His Refusal to Certify the Bank's Financials Pursuant to SOX Constitutes Protected Activity

Welch's claims had their genesis in SOX. [RDO, JA 345] Welch repeatedly told Moore "that too many people were making journal entries without (his/Welch/the CFO's) approval," citing as an example the two entries "totaling $195,000" in his August and September 2002 memoranda and attachments. [JA 275; JA 276-284; JA 355]

The ALJ noted, referring to paragraph two of JA 277, that the SOX certificate stated "this quarterly report does not contain any untrue statement of a material fact" and "is not misleading with respect to the period covered by the report (10-QSB)" [JA 358] Welch specifically noted "income should be restated to properly account for the $195,000 recoveries." [JA 277, 283, 355]

The ALJ noted 3rd quarter "income and balance sheets (for 2001) would appear in the following year in the third quarter of 2002 as **comparative statements relied upon by investors.**" [JA 357] Welch testified Moore's "**practices of making credit entries to Sundrey Credits and debit entries to Sundrey Expenses at year end . . . are misleading to the financial statement reader.**" [JA 359]

At JA 400, the ALJ holds: "The third-quarter (SOX) certification required Welch to insure that Cardinal's quarterly report contained no "untrue statement of a material fact" and "fairly presented in all material respects the bank's financial conditions. Welch could have reasonably believed he could not make the necessary certification because the entries in question resulted in material misstatement of Cardinal's status." [JA 400]

Welch repeatedly reported to Respondent his concern that Cardinal's internal controls were deficient because "[a]ll too often, journal entries (that should have prior review) are made by persons outside the finance Department without the CFO's review or knowledge" (CX 17). As examples, Welch cited the two improper entries totaling $195,000 as well as entries to sundry accounts (CX 20, CX 23 at 2-3, 5-7). In particular, he indicated that the entries for $195,000"were made by someone not having the appropriate knowledge relating to generally accepted accounting principles, FFIEC guidelines or IRS regulations" (CX 23 at 3). Furthermore, in his September 13th memorandum to Moore, Welch also asserted that he was not given a chance to review such journal entries, as required by his job description (CX

23 at 5-7; Tr. 61).

The ALJ specifically relied upon the SOX 10-QSB and the SOX certificate, both of which became law and were required filings with the passage of SOX on July 30, 2002. The Fourth Circuit's insistence Welch "utterly failed to explain how Cardinal's alleged conduct could reasonably be regarded as violating any of the laws listed in §1514A" of SOX **overlooks the specific requirements of SOX** laid out by Welch in his memoranda and exhibits. Welch could not certify the bank's financial statements as satisfying the precise language of the SOX certificate. **The Fourth Circuit's "other worldly" view of §1514A excludes compliance with the SOX certificate as one of the "laws listed in §1514A." Problems with the bank's SOX documents themselves (10-QSB and SOX certificate) were, at every level of this proceeding, advanced by Welch and were "self-enunciating."**

The Fourth Circuit cites *Hall v. U.S. Department of Labor, Administrative Review Board*, 476 F.3d 847, 861 n. 8 (10th Cir. 2007) to support the proposition that the ARB "does not have to 'sua sponte' raise legal theories referenced obliquely but not clearly articulated." Here, Welch communicated exactly why he could not certify the bank's 10-QSB or execute the SOX certificate. **He raised issues regarding the material accuracy of financial statements and internal financial controls specifically required by SOX.** [JA 14-29] The ALJ made specific findings regarding this testimony. Welch distinguished between non public filings he approved and the SOX filings, which he refused to certify. **"With respect to**

the SOX 10-QSB's, he testified, in contrast, they contained comparative financial information, they were for public consumption, the Sarbanes-Oxley Certification contained a more rigorous standard, the Act (SOX) provided for specific penalties for false certifications, and it (SOX) promised to protect his employment in the event he raised concerns about improper conduct." [JA 401; Tr. 69-72]

The very heart and soul of every complaint dealt with the certification mandate of SOX. Welch provided his thinking to the CEO of the bank through memoranda, SOX Form 10-QSB notes, and the SOX certificate, with notes. **Point by point, he explained his position relative to SOX and the public financial disclosures regarding the bank's financial condition and internal financial controls. To exclude the very requirements of SOX from §1514A's coverage "any provision of Federal law relating to fraud against shareholders ignores the requirements of SOX specifically designed to protect investors." This is error as a matter of law.**

Welch's SOX objections are interlaced throughout every shred of evidence presented. Unlike the *Hall* case cited by the Fourth Circuit, in which there was an attempt to raise a novel theory of constructive discharge, **Welch consistently alleged and introduced evidence as to why he could not SOX certify the bank's financials or sign the SOX certificate.**

The record evidence clearly establishes that Welch, before the ALJ, the ARB and the Fourth

Circuit, set out the specific rationale for his refusal to SOX certify.

C. Welch Raised All Relevant Issues Below

Welch's Reply Brief to the ARB at pages 2 and 3 adopted "the summary of the evidence of ALJ Purcell contained within the RDO (JA 344-394) on pages 2-50 as if copied verbatim herein."

At page 7 of the Reply Brief he states: "As demonstrated by CX 27, pages 6-14, Welch details with specificity certain actions by Cardinal which came within the purview of Section 806 of Sarbanes-Oxley. The most significant are accounting issues which inflated Cardinal's financial statements upon which the investing public relies to make investment decisions." [CX 27, 6-14] The ARB had before it each and every argument and exhibit advanced by Welch relative to SOX. See: Attached Addendum for CX 27, 6-11; Memorandum of August 14, 2002 (JA 225); Memorandum of September 13, 2002 (JA 276-284).

The ARB was directed to each and every SOX concern raised by Welch. These same SOX concerns were raised at every stage (OSHA; ALJ; ARB; Fourth Circuit). The Fourth Circuit's logic demonstrates a blinder vision approach to SOX. From an alternate universe perspective, the Fourth Circuit eerily gazes past Welch's specific SOX complaints to see – nothing.

The Fourth Circuit cites *Taylor v. U.S. Department of Labor*, 440 F.3d 1, 8-9, for the proposition that Welch "raised new arguments relying

on newly identified authorities," concluding "Welch has forfeited these new arguments by failing to raise them before the ARB."

The *Taylor* case dealt with a situation in which appellant, for the first time at the appellate level, raised a waiver of immunity claim "never raised before either the ALJ or the ARB." Here, Welch fully and completely articulated all factual and SOX compliance issues before OSHA, the ALJ, the ARB and the Fourth Circuit, specifically including rationale for his refusal to SOX certify the bank's SOX required financials.

CONCLUSION

Seven years after the passage of SOX the banking industry is dominated by brazen fraud. SOX must be broadly construed, and Welch's petition for review should be accepted to put an end to banking industry fraud.

Respectfully Submitted,

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The Bank of Floyd
MEMORANDUM

To: Leon Moore
From: Dave Welch
Date: August 14,2002

Re: 10Q for the Quarter Ended June 30, 2002

After attempting to tie Larrowe & Company's figures to our FR Y9LP, FR Y9C and Cardinal's Consolidated financials for June 30th. I am unable to reconcile their's to ours. There are no explanatory notes that might help explain the differences.

More importantly, though, as I have stated to you on numerous occasions in the past, when there are so many people making journal entries without my knowledge or approval, I cannot give any assurances that our financials are fairly presented. For example, last year, you approved Journal entries for the $45,000 and $150,000 recoveries of written-off loans to be entered as other income and other real estate income. In spite of my repeated attempts to get you to correct the entries, you stood firm against any changes. It wasn't until I brought them to Beth's attention at year-end that the proper adjustments were made.

Just last month, while performing a routine review of some expense accounts, I noted some of the entries you had authorized at 2001 year-end charging $4500 and expenses against 2001 income. Then, in May, you authorized the reversal of those entries. The result of these two sets of entries was a decrease in taxable

income in 2001, a decrease in expenses in 2002 and an increase in net income for 2002. We discussed this practice the first year I came here. As I said then, this type of accounting. It also hints that at "managing" net income which has always been unethical and is now seriously a legal.

Not only can I not certify the accuracy of Cardinal's financial statements as required by our most recent legislation. I cannot offer any assurances as to their fair presentation as presented in the 10Q you asked me to review. Since Larrowe & Company lists you as the Principal Financial Officer of Cardinal Bankshares Corporation, you may certify the accuracy of the financial statements is presented, but I cannot.

The Bank of Floyd
MEMORANDUM

To: Leon Moore
From: Dave Welch
Date: September 13, 2002

Re: 10-QSB Certifications

Two weeks from Monday, the 3rd quarter will be ending. Shortly thereafter, another 10-QSB will be due. It would be my preference to avoid the friction experience last quarter. In order to avoid any misunderstandings, I have attached a section 302 certification that contains the verbage require by the Sarbanes-Oxley Act of 2002 along with explanatory notes. The Section 302 certification is required each quarter beginning with September 30, 2002 10-QSB. It is also required to be part of the 10-QSB rather than being filed as a separate document. This is to assure its availability to anyone who wishes to review Cardinal's financials.

The first copy of the 302 certification is as it should be submitted except for the signature and date. The second copy has key phrases underlined and in bold type. Each of these phrases is connected to a comment box which has a brief explanation as to why I will not be able to certify the third quarter's 10-QSB.

The certification submitted with your "signature" last quarter will not suffice this quarter for two reasons. First, the section 302 certification as noted above must now be submitted. Second, there are material items in the 2001 3rd quarter figures and 2001 3rd quarter YTD

figures that should be restated. The restatement should be done in order to avoid the unfair presentation of financial statements which could lead a reasonable investor to make a decision they might otherwise not make.

I would like to address these issues with you today so you can have something to think about over the weekend. We need to read some resolution.

Form 10-QSB

CERTIFICATIONS

I, David E. Welch, certified that:

1. I have reviewed the quarterly report on Form 10-QSB of Cardinal Bankshares Corporation

2. Based on my knowledge, this **quarterly report does not contain any untrue statement of a material fact** or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, **not misleading with respect to the period covered by this quarterly report**:

3rd Qtr 2001 income should be restated to properly account for the $195.000 recoveries

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, **fairly present in all material respects the financial condition, results of operations** and cash flows of the registrant as for, and for, the periods presented in this quarterly report;

L & C communicates exclusively with CEO on all disclosure matters

4. The registrant's **other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures** (as defined in

Exchange Act Rules 13a and 15d-14) for the registrant and have;

I have not participated nor been consulted in the design of disclosure controls and procedures

(a) **design such disclosure controls and procedures** to ensure that the material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) **evaluated the effectiveness of the registrant's disclosure controls and procedures** as of the date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

I have not evaluated the effectiveness of disclosure controls and procedures

(c) **presented in this quarterly report our conclusion about the effectiveness of the disclosure controls and procedures based on our evaluation** as of the Evaluation Date;

No evaluation. The CFO isn't permitted to address Audit Committee or Board

5. The registrant's other **certifying officers and I have disclosed** based on our most recent evaluation, **to the registrant's auditors and the audit committee or registrant's Board of Directors** (or persons performing the equivalent functions):

Only the deficiency of too many non-accounting people making JEs w/o Finance review or approval has been brought to the attention of CEO & External Auditors.

Dual control does not make an entry meet GAAP

(a) **all significant deficiencies in the design or operation of internal controls** which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weakness in internal controls; and

If insider trading is considered fraud, it has been reported to CEO

(b) **any fraud**, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control; and

see previous comments

6. The registrant's **other certifying officers and I have indicated** in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

David E. Welch, CPA, Chief Financial Officer

Item # /Comments or Recommendation

1. Self-explanatory. No comments necessary.

2. The following two phrases are related:

a. "... quarterly report does not contain any untrue statement of a material fact..." and

b. "... not misleading with respect to the period covered by this quarterly report;"

In June and July of 2001, we received two recoveries on loans that had been written off quite some time before. When these monies were received they should have been given to me with an explanation as to what they were for. Instead of booking them improperly as income, I would've booked both the $45,000 and the $150,000 amounts to the Valuation Reserve.

As it occurred, the entries were made by someone not having the appropriate knowledge relating to generally accepted accounting principles, FFIEC guidelines or IRS regulations. As a result, when I found the entries during my monthly G/L review, I brought them to your attention to get the entries changed.

Over the course of the last six months of 2001, I brought this issue to your attention at each of our Senior Officer meetings. Each time, you disagreed with my opinion and with the regulations or refuse to change the entries. At year end, Larrowe & Company made the changes as I had previously recommended.

As a result of these incorrect entries, Income, after

income tax a fact, was overstated by 13.7% for the third quarter of 2001 and 7.4% for the YTD September 30, 2001.

Net Loans were overstated by $195,000 (only 0.2%); Valuation Reserves were understated by $195,000 or 14.1%; Other Liabilities were overstated by $66,300 or 17.4%; and Retained Earnings were overstated by $128, 700 or 4.5%.

Therefore, the Income Statement, Balance Sheet, and Cash Flow Statement for the third quarter of 2001 should be restated to accurately reflect the results of operations, financial condition, and cash flows (see attached sample Income Statement and Balance Sheet).

RECOMMENDATIONS: (1) Abide by the policies that my job description implies are in existence and (2) lounge to follow these policies.

Examples of these policies are:

a. "compiles and analyzes financial information to prepare entries to accounts, such as general ledger accounts, documenting business transactions."

b. "Determines proper handling of financial transaction and approve transactions within designated limits."

c. "Monitors compliance with generally accepted accounting principles and company procedures."

3. the phrase "... fairly present in all material respects the financial condition, results of operations..." applies to the figures noted in item number two above. These are material amounts and could, conceivably, impact the decision-making of a potential investor relying on those numbers.

RECOMMENDATION: permit me to perform the job functions as outlined in my job description.

Examples would include:

a. the three items listed in item 2 recommendations above, and

b. "on its contracts, orders, and vouchers, and prepares reports to substantiate individual transactions prior settlement", and

c. "reviews, investigate, and corrects errors and inconsistencies in financial entries, documents, and reports."

4. the phrase "other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures..." is a significant process in which I had no input. Since your memo states that you are "well aware of the certification process and... well aware of the needs... discussed", I won't bore you with the requirements. However, I cannot swear (or certify) that I:

a. "designated such disclosure controls and procedures..." since I did not participate in their design.

b. "the body weighted effectiveness of the registrant's disclosure controls and procedures..." since they have not been presented to me for evaluation.

c. "presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation..."

I could not state what I did not do.

RECOMMENDATION: Permit me to review the disclosure controls and procedures you have put into place in order to evaluate their effectiveness.

5. I cannot swear to the statement, "The registrant's other certifying officers **and I** have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee or registrant's Board of Directors (or persons performing the equivalent functions)" as the statement relates to items (a) and (b) below:

(a) "all **significant deficiencies in the design or operation of internal controls** which could adversely a fact the registrant's ability to record, process, summarizing report financial data and have identified for the registrant's offers any material weaknesses in internal controls";

since you are the only person who reports to the board and I have been instructed by you not to address the audit committee and you have been (practically) exclusive contact with Larrowe & Company, I cannot certify any portion of this statement.

This is not a situation seen in very many banks. Most banks have at least two officers on the board for purposes of accountability as well as for providing diversification of opinion on loan generation methods, marketing approaches, accounting and other operational issues that come before the board.

On several occasions over the past 3 ½ years, I have mentioned to you and to Larrowe & Company the deficiency of too many people (who have no accounting or finance expertise) making journals entries without giving Finance an opportunity to review or approve them. This situation relates to my recommendation for items two and three above.

Of course, routine journal entries, such as the ones Pat Harris makes to allocate the cost of the deposit tickets, etc. to the branches or the income tax entries Customer Service makes pertaining to deposit interest payments would not require review.

Sometimes, we may be under the mistaken impression that two signatures validate a journal entry. That is not necessarily so. As we have observed, it sometimes just means that two people are wrong. As I have often said, "Dual control does not make an entry meet GAAP."

(b) "**any fraud**, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls";

If the asppearance of insider trading would be considered fraud, then I have reported this to you.

Another issue that I have brought your attention is the

practice of making credit entries to Sundry Credits (liability account) and debit entries to Sundry Expenses at year-and. These are misleading to the financial statement reader.

While the entries alone somewhat misleading, the entries made in the following year that reversed the Sundry Credits entries (debits) and reduce the expense accounts such as Education Expense, Transportation and Travel and Meal Expense and Officer Expense are even more misleading. As a result of this second set of entries, it appears that expenses for the second year are less than they actually were, thus, overstating net income in the second year.

While this may have been an acceptable practice many years ago, generally accepted accounting principles requires that income and expenses be matched against the period in which they are incurred.

RECOMMENDATION: Permit me to perform the job functions as outlined in my job description. Listed below are the items previously noted in items two and three above:

a. "compiles and analyzes financial information to prepare entries to accounts, such as general ledger counts, documenting business transaction";

b. "Determines proper handling of financial transaction and approves transactions within designated limits";

c. "Monitors compliance with generally accepted accounting principles and company

procedures";

d. "Audits contracts, orders, and vouchers, and prepares reports to substantiate individual transactions prior to settlement"; and

e. "Reviews, investigate, and corrects errors and inconsistencies in financial entries, documents, and reports."

6. "The registrant's other certifying officers **and I** have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies in material weaknesses."

I cannot swear to this assertion since there has not been a recent evaluation of internal controls in which I participated.

RECOMMENDATION: Permit me to review the findings on the most recent review of internal controls in order to evaluate whether any material weaknesses exist.

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Cardinal Bankshares Corporation (the "Company") on Form 10-Q for the period ending June 30, 2002, as filed with the Securities and Exchange Commission on the date here of (the "Report"), the undersigned **Chief Executive Officer AND Chief Financial Officer** of the Company hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that, based on our knowledge and belief: (1) **the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (2) the information contained in the Report fairly presents** in all material respects, the financial condition and results of operations of the Company as of and for the periods covered in the report

_____

Ronald Leon Moore, Chief Executive Officer

_____

David E. Welch, CPA, Chief Financial Officer

_____, 2002

Absence of both signatures results in not being in compliance.

No attempt was made by CEO to bring the financial statements into compliance.

The issues noted in a memo to the CEO were not discussed with the CFO.

Section 1350 of the Sarbanes-Oxley Act of 2002 states: "Whoever willfully certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than $5,000,000, or imprisoned not more than 20 years, or both".

The attached submission fails two tests. (1) It does not contain both signatures, and (2) it was submitted knowing there were issues with fair presentation and accuracy.

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Cardinal Bankshares Corporation (the "Company") on Form 10-Q for the period ending June 30, 2002, as filed with the Securities and Exchange Commission on the date here of (the "Report"), the undersigned Chief Executive Officer and Chief Financial Officer of the Company hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that, based on our knowledge and belief: (1) to the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (2) the information contained in the Report fairly presents in all material respects, the financial condition and results of operations of the Company as of and for the periods covered in the report

_____

Ronald Leon Moore, Chief Executive Officer

_____

David E. Welch, CPA, Chief Financial Officer

_____, 2002

Form 10-QSB

CERTIFICATIONS

I, David E. Welch, certify that:

1. I have reviewed the court would report on Form 10-QSB of Cardinal Bankshares Corporation.

Without the external auditor's work papers, I will not be able to reconcile their numbers on the 10-USB to our general ledger numbers.

In order, the external auditor has failed to respond to my request for their work papers.

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report:

In June and July of 2001, we received two recoveries on loans that had been written off quite some time before. When these monies were received they should have been given to me with an explanation as to what they were for. Instead of booking them improperly as income, I would've booked both the $45,000 and the $150,000 amounts to the Valuation Reserve.

As it occurred, the entries were made by someone not having the appropriate knowledge relating to generally accepted accounting principles, FFIEC guidelines or IRS regulations. As a result, when I

found the entries during my monthly G/L review, I brought them to your attention to get the entries changed.

Over the course of the last six months of 2001, I brought this issue to your attention at each of our Senior Officer meetings. Each time, you disagreed with my opinion and with the regulations or refuse to change the entries. At year end, Larrowe & Company made the changes as I had previously recommended.

As a result of these incorrect entries, Income, after income tax a fact, was overstated by 13.7% for the third quarter of 2001 and 7.4% for the YTD September 30, 2001.

Net Loans were overstated by $195,000 (only 0.2%); Valuation Reserves were understated by $195,000 or 14.1%; Other Liabilities were overstated by $66,300 or 17.4%; and Retained Earnings were overstated by $128, 700 or 4.5%.

Therefore, the Income Statement, Balance Sheet, and Cash Flow Statement for the third quarter of 2001 should be restated to accurately reflect the results of operations, financial condition, and cash flows (see attached sample Income Statement and Balance Sheet).

On September 19, 2002, our CEO instructed me to restate the financials however I want to. However, I can only restate our internal documents. Our external auditors prepared the 10-QSB which must be restated for the third quarter 2001. Then, the external auditors, along with our CEO, must

decide what disclosure statements must be included. The restatements for the third quarter 2001 within ripple through the 10-KSB and the first and second quarter 2002 10-QSBs.

In addition to the 10-QSB, the third and fourth quarter 2001 Call Reports and FR Y9 (Holding Company) Reports must also be resubmitted along with the appropriate action to limit for a comments. The changes in the third and fourth quarter 2001 reports will ripple through to the first and second quarter reports as well.

CFO's RECOMMENDATIONS: (1) Abide by the policies that my job description implies are in existence and (2) lounge to follow these policies.

a. "compiles and analyzes financial information to prepare entries to accounts, such as general ledger accounts, documenting business transactions."

b. "Determines proper handling of financial transaction and approve transactions within designated limits."

c. "Monitors compliance with generally accepted accounting principles and company procedures."

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as for, and for, the periods presented in this quarterly report;

This section applies to the figures described in item 2 above. These are material amounts incurred, conceivably, impact the decision-making of a potential investor relying on those numbers.

CFO's RECOMMENDATION: Permit me to perform the job functions as outlined in my job description. For example, the CFO, in addition to the two points listed in item 2 above,

a. "Audits contracts, orders, and vouchers, and prepares reports to substantiate individual transactions prior to settlement"; and

b. "Reviews, investigate, and corrects errors and inconsistencies in financial entries, documents, and reports."

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a and 15d-14) for the registrant and have;

(a) designed such disclosure controls and procedures to ensure that the material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of the date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

(c) presented in this quarterly report our conclusion about the effectiveness of the disclosure controls and procedures based on our valuation as of the Evaluation Date;

The three steps above our parts of a significant process in which I have had no input. I cannot certify that I did beast for I did not.

<u>CFO's RECOMMENDATION</u>: Permit me to review the disclosure controls and procedures that have been put into place by the CEO in order to evaluate their effectiveness.

5. The registrant's other certifying officers and I have disclosed based on our most recent evaluation, to the registrant's auditors and the audit committee or registrant's Board of Directors (or persons performing the equivalent functions):

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weakness in internal controls; and

Since the CEO is the own person her reports to the board and I have been instructed by the CO not to address the audit committee and the CEO has been the (practically) exclusive contact with Larrowe & Company, I cannot certify any portion of this statement.

This is not a situation seen in very many banks.

Most banks have at least two officers on the board for purposes of accountability as well as for providing diversification of opinion on loan generation methods, marketing approaches, accounting and other operational issues that come before the board.

On several occasions over the past 3 ½ years, I have mentioned to you and to Larrowe & Company the deficiency of too many people (who have no accounting or finance expertise) making journals entries without giving Finance an opportunity to review or approve them. This situation relates to my recommendation for items two and three above.

Of course, routine journal entries, such as the ones Pat Harris makes to allocate the cost of the deposit tickets, etc. to the branches or the income tax entries Customer Service makes pertaining to deposit interest payments would not require review.

Sometimes, we may be under the mistaken impression that two signatures validate a journal entry. That is not necessarily so. As we have observed, it sometimes just means that two people are wrong. As I have often said, "Dual control does not make an entry meet GAAP."

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control; and

If the appearance of insider trading is considered fraud, it has been reported to CEO.

Another issue that I have brought your attention is the practice of making credit entries to Sundry Credits (liability account) and debit entries to Sundry Expenses at year-and. These are misleading to the financial statement reader.

While the entries alone somewhat misleading, the entries made in the following year that reversed the Sundry Credits entries (debits) and reduce the expense accounts such as Education Expense, Transportation and Travel and Meal Expense and Officer Expense are even more misleading. As a result of this second set of entries, it appears that expenses for the second year are less than they actually were, thus, overstating net income in the second year.

While this may have been an acceptable practice many years ago, generally accepted accounting principles requires that income and expenses be matched against the period in which they are incurred.

CFO's RECOMMENDATION: Permit me to perform the job functions as outlined in my job description. Listed below are the items previously noted in items two and three above:

a. "compiles and analyzes financial information to prepare entries to accounts, such as general ledger counts, documenting business transaction";

b. "Determines proper handling of financial transaction and approves transactions within designated limits";

c. "Monitors compliance with generally accepted accounting principles and company procedures";

d. "Audits contracts, orders, and vouchers, and prepares reports to substantiate individual transactions prior to settlement"; and

e. "Reviews, investigate, and corrects errors and inconsistencies in financial entries, documents, and reports."

6. The registrant's other certifying officers and I have indicated in this courtly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

I cannot swear to this assertion since there has not been a recent evaluation of internal controls in which I participated.

CFO's RECOMMENDATION: Permit me to review the findings on the most recent review of internal controls in order to evaluate whether any material weaknesses exist.

David E. Welch, CPA, Chief Financial Officer

CARDINAL BANKSHARES CORPORATION AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEET AS OF SEPTEMBER 30

(in thousands)	Restated 2001	2001	2000
ASSETS			
Cash and due from banks	$3270	$3270	$2631
Investment securities	46867	46867	57303
Loans, net	113000	113195	92602
Premises and equipment	2356	2356	2487
Fed Funds sold	9800	9800	4475
Other Assets	2351	2351	3742
Total Assets	$177644	$177839	$163240
LIABILITIES			
Deposits	$155445	$155445	$143033
Other liabilities	711	777	529
Total liabilities	156156	156222	143562
STOCKHOLDERS' EQUITY			
Common stock*	15357	15357	5119
Surplus	2925	2925	2925
Retained Earnings	2862	2990	11765
Unrealized gains/ (losses) on securities held for sale	344	344	(131)
Total liabilities and stockholders' equity	$177644	$177838	$163240

*1,535,733 and 511,911 shares issued in 2001 and 2000 respectively.

CARDINAL BANKSHARES CORPORATION AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF INCOME THIRD QUARTER

In thousands, except per share data	Restate 2001	2001	2000
Interest income	$3302	$3302	$2919
Interest expense	1672	1672	1499
Net interest income	1630	1630	1420
Provision for credit losses	145	145	150
Net interest income after provision for credit losses	1485	1485	1485
Other income	20	170	91
Other expense	714	714	796
Income before income taxes	791	941	565
Income tax exposure	166	217	121
Net income	$625	$724	$444
Net income per share	$0.41	$0.47	$0.30

Number of Shares 1535733 1535733 1477233
Stock Split Restated Retroactively

CARDINAL BANKSHARES CORPORATION AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF INCOME YEAR-TO-DATE THROUGH SEPTEMBER

In thousands, except per share data	Restate 2001	2001	2000
Interest income	$9501	$9501	$8578
Interest expense	4908	4908	4404
Net interest income	4593	4593	4174
Provision for credit losses	400	400	400
Net interest income after provision for credit losses	4193	4193	3774
Other income	254	449	256
Other expense	2342	2342	2338
Income before income taxes	2105	2300	1692
Income tax exposure	480	546	359
Net income	$1625	$1754	$1333
Net income per share	$1.06	$1.14	$0.90

Number of Shares 1535733 1535733 1477233
Stock Split Restated Retroactively